



# United States Department of the Interior

## BUREAU OF LAND MANAGEMENT

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Instruction Memorandum No. NM-2005-017  
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To: DM's and FM's

From: DSD, Minerals and Lands

Subject: Guidance on Statute of Limitations as it Applies to the Drainage Program

### Background

New Mexico last issued guidance on a Statute of Limitations (SOL) in 1993, under Instruction Memorandum (IM) 93-250 (Attachment 1). This IM interpreted and applied to New Mexico nationwide guidance issued through IM 93-287 (Attachment 2).

The objective of both IMs was to establish a priority for identification and resolution of drainage cases. State and/or Field Offices were encouraged to promptly notify lessees of potential drainage, and promptly resolve, or administratively close, older cases.

Accordingly, offices were told to close all Federal cases where no demand letter had been written, and more than 10 years had elapsed since drainage had ceased (all Indian drainage cases were to be pursued to completion). Also, offices were instructed to assign a priority to other cases based upon the amount of the potential compensatory royalty assessment. The IM did not state conclusively that case establishment started the ticking of a SOL clock, but alerted offices that a SOL could affect collection of compensatory royalties for older cases.

We believe that WO issued IM 93-287 to help the Field Offices reduce the large nationwide inventory of open drainage cases. The WO had concern that application of a SOL could render these cases moot. The WO wanted to ensure that states would concentrate their efforts on cases that had the greatest potential for recovery of significant compensatory royalties.

Both IMs predate the Federal Oil and Gas Royalty Simplification and Fairness Act of 1996 (RSFA), and the June 2001, revision in the drainage regulations. We believe that it is appropriate to issue new guidance in light of these changes.

### RSFA

Section 4 of the RSFA (Attachment 3) created a seven-year SOL applicable to “demands” related to royalty minimum royalty, rents, bonuses, etc. The MMS will not issue a demand for payment of royalty or other amounts accruing more than seven years before the date of the demand. We have been told by Interior Department solicitors that this provision does not apply to administrative cases and lease requirements such as drainage.

### Drainage Regulations

Prior to the 2001 revision, the only regulation that dealt with drainage of Federal oil and gas leases was 43 CFR 3100.2-2. It stated that lessees shall drill and produce all wells necessary to protect the leased lands from drainage, or pay compensatory royalty. The WO guidance, in the form of IMs, a Drainage Manual and Handbook provided policy and procedures for the drainage program. Policy and procedures evolved over the years as a means of incorporating precedents in numerous decisions of the Interior Board of Land Appeals (IBLA). In effect, the IBLA established our guidance concerning ‘constructive’ versus ‘actual’ notice, and the earliest date from which compensatory royalties may be assessed (the ‘reasonable time’ after notice). No drainage decisions dealt with a SOL.

The revised drainage regulations, under 43 CFR 3162.2, changed the whole focus on drainage protection. Now, it is Federal and Indian lessees who are responsible for tracking new producing wells located in proximity to their leases. Lessees must identify potential drainage situations, contact the appropriate Field Office of the need (if any) to protect their leases from drainage, and provide their plans for prevention of further drainage (or explain why drainage is not occurring, and/or a paying protective well may not be drilled). With the onus now shifted to lessees, the question arises as to the applicability of a SOL.

We believe that the conditions under which the 1993 guidance were issued no longer apply to the New Mexico organization. You no longer maintain a large backlog of unresolved cases where you have not yet contacted the lessees.

### Policy Implementation

Under 43 CFR 3162.2-6, the lessee is considered to have constructive notice of potential drainage on the first production date of the offending well. Lessees have not been contacting Field Offices with their plans to protect the lease from drainage. Your office must continue to track new well completions to identify potential drainage situations. If there is potential drainage, you should contact the lessee and remind them of the provisions of 3162.2.

The Bureau of Land Management (BLM) has no SOL, but, we believe Minerals Management Service (MMS) will not attempt to collect compensatory royalties for older cases. Therefore, if more than seven years have elapsed since the date the offending well last produced, or the date that a protection well was completed, close those Federal drainage cases. If BLM wants MMS to assess the maximum value for compensatory royalty, we must issue the demand letter within seven years of the date of first production. Otherwise, we may lose the ability to collect compensatory royalty for the early production.

As in the 1993 IMs, it is always appropriate to reexamine cases where the expected Federal compensatory royalty assessment is 'insignificant' (set in 1993 as \$4,000), due to poor reservoir quality, different lease accounts or Federal allocation percentages, and administratively close those cases.

The NM IM 98-041 (Attachment 4) raised this limit to \$7,500. Economic conditions have changed such that we believe it appropriate to raise the limit yet again, to \$10,000. The \$10,000 limit is an estimate of the cost to initiate a drainage case and carry it through assessment and appeal.

If you calculate compensatory royalty at less than \$10,000, you may close the case. This limit applies equally to incremental drainage that has a definite ending date due to cessation of production from the offending well, or completion of a protective well. Document your rationale and application of the threshold when you close the case.

Again, dollar and time thresholds set forth in this IM apply only to Federal drainage. In order to fulfill our Trust obligations to Native Americans, all Indian drainage cases in which a paying protective well could be drilled must be pursued, regardless of the value of compensatory royalty, or the passage of time.

If you have any questions or need further clarification, please contact Jay Spielman, Geologist, at (505) 438-7503.

Signed by:  
Steven R. wells  
Acting

Authenticated by:  
Marcy Romero

4 Attachments:

- 1- IM 93-287 (4 pp)
- 2- NM IM 93-250 (2 pp)
- 3- Section 4 of RSFA (2 pp)
- 4- NM IM 98-041 (2 pp)

Distribution

WO (310, D. Shaw), LS Rm. 501 - 1  
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